

# **College Savings Plans of Maryland**

## **2004 Budget Testimony**

### **House Appropriations Committee Subcommittee on Education and Economic Development**

**March 2, 2004**

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Mr. Chairman, Members of the Subcommittee,

On behalf of the Board, I am pleased to present to you the progress the College Savings Plans of Maryland has made over the past year in both the Maryland Prepaid College Trust and the Maryland College Investment Plan.

### **Maryland Prepaid College Trust (Prepaid College Trust)**

The Prepaid College Trust is currently in its 7<sup>th</sup> Enrollment Period, which began on November 17, 2003. The following are some current statistics on the Plan:

- ✓ Approximately 19,765 active accounts
- ✓ About 63% of all participants purchase a 4 Year University Contract
- ✓ About 30% of all participants select the lump sum payment option when they enroll.

Like most prepaid tuition programs across the country, recent increases in tuition costs have had significant negative effects on the Prepaid College Trust, relative to contract pricing, and the Trust's actuarial valuation.

### **Tuition Environment**

Regarding the determination of contract prices, two of the factors that the Prepaid College Trust uses to determine contract prices include current tuition and mandatory fees at Maryland public colleges, as well as projected future increases in tuition and mandatory fees. Contract prices for the Prepaid College Trust have increased by about 25% per year for the past two years because of significant, and sometimes unexpected, increases in tuition, combined with changes in the long term projection for future tuition increases (from 5% to 6% per year, then from 6% per year to 11% for 2004-2005, 9% for 2005-2006, 8% for 2006-2007, and 6% for each subsequent year).

Following are some statistics from the current (seventh) enrollment period:

- ✓ Approximately 1,380 new enrollments through February 26, 2004, which appears to be on track to meet our enrollment goal of 4,000 by the close of the enrollment period on March 19, 2004
- ✓ Market Value of the Trust's Assets -- \$230 million as of January 31, 2004h, nearly double the asset size of one year ago
- ✓ Average Lump Sum Payment for 4 Years University -- \$31,644, or a 25% increase over last year's lump sum average of \$25,330.

As shown above, the Prepaid College Trust continues to attract new entrants despite a significant increase in contract prices. We believe that this can be primarily attributed to the current environment of higher and more frequent tuition increases, which adds to the uncertainty in many families' minds about how much college will cost 10-15 years from now. Many of these families are concluding for the first time that there is value in locking in to a payment plan that based on

current tuition costs that assures a defined future tuition benefit that can be used at nearly any college nationwide.

### **Actuarial Valuation Study**

**Background:** Each year, the Board's actuary determines the actuarial valuation of the Prepaid College Trust. This study compares the market value of the Trust's current assets, including the value of future payments by participants, with the future expected liabilities, the majority of which are tuition payments. Since the Trust's launch in 1998 until the end of FY01, the Trust had maintained an actuarial surplus, meaning that the projected value of the Trust's assets exceeded its projected liabilities. However, higher than expected actual tuition and mandatory fees, combined with an increase in the projection for future tuition increases and lower than projected stock market performance in 2000 – 2002 combined to create the Trust's first actuarial deficit of \$31 million for FY02. This actuarial deficit results in the Trust being 89% funded.

For FY03, the Prepaid College Trust had an actuarial deficit of \$69.9 million as of June 30, 2003. The increase in the actuarial deficit from \$31 million to \$69.9 million is the result of two primary factors:

- 1- Tuition and mandatory fee increases for the 2003-2004 academic year were again larger than anticipated; and
- 2- Our projected future tuition increases rose from 6% annually to 11% for the 2004-2005 academic year and 6% for each following year.

This means that the increase in the actuarial deficit from fiscal year 2002 to 2003 is entirely tuition related and not due to investment performance. In fact, investment earnings for the past fiscal year were on target at 7.51% vs. an earnings projection of 7.5%.

### **Board's Actions**

The Board has taken a number of steps in response to current tuition conditions, the current market environment, and the resulting Actuarial Valuation Study:

- 1- When determining contract prices for the current enrollment period, the Board decided to:
  - a. **Project an 11% increase in tuition for the 2004-2005 academic year, with a projected tuition increase of 9% for 2005-2006, 8% for 2006-2007, and 6% for each following year.** Mandatory fees continue to be projected to increase at 10% per year.
  - b. Enter the second year of a five-year **amortization of the unanticipated actuarial losses** associated with the May 2002 increase in tuition and mandatory fees by the University System for the 2002-2003 academic year. It also decided to enter the first year

of an eight-year amortization of unanticipated actuarial losses caused by the total increase in Tuition by the University System of Maryland for the 2003-2004 academic year.

- 2- The Board has been **partnering more effectively with the University System** in determining the impact on the Prepaid College Trust of tuition actions by the Board of Regents, due in large part to the addition of the Chancellor of the University System of Maryland as a member of the College Savings Plans of Maryland Board.
- 3- The Board is continuing to **actively monitor its investment policy**, with the aid of its investment advisor. The Board receives semi-annual updates on the investment performance of the Prepaid College Trust. The most recent semi-annual review was held on February 26, 2004 for the period of July-December 2003. The total return for the Trust for that period was 10.6%.
- 4- Given the FY03 actuarial deficit, the Board requested its actuary to provide an **interim actuarial update for July - December 2003**. This interim update reflected the strong investment performance of the Trust for July - December 2003. The Board's actuary indicated that the updated actuarial deficit of the Trust as of December 2003 has decreased from \$69.9 million to \$54.5 million, since the Prepaid College Trust's investment return for July - December 2003 significantly exceeded the projected actuarial return of 7.65% annually. The Prepaid College Trust also moved from being 82% funded as of June 30, 2003 to being 89% funded as of December 31, 2003.

Both the Trust's actuary and its financial consultant from Southeastern Advisory Services, Inc. work with other state prepaid tuition programs. They have frequently commented not only on the soundness of the Board's approach to setting prices, pricing assumptions, and investment policies, but its soundness as compared to other state programs' policies in the same areas.

### **Maryland College Investment Plan (MCIP)**

The College Savings Plans of Maryland Board opened the MCIP in December 2001. In just over two years of operation, the Investment Plan has grown considerably.

- ✓ Assets totaling over \$487 million as of January 31, 2004
- ✓ Over 65,000 accounts as of January 31, 2004
- ✓ Average account balance is \$7,423
- ✓ Average number of accounts per Account Holder – 2.1 (vs. 2.6 one year ago)

The MCIP continues to attract investors interested in saving for college. It allows investors to choose their investment option as well as how much and how often they wish to invest, which affords flexibility not found in the Prepaid College Trust.

### **College Savings Plans of Maryland**

The College Investment Plan and Prepaid College Trust are marketed together under the umbrella name of the College Savings Plans of Maryland. Both programs are reachable through a single toll-free number (1 888 4MD GRAD) and one web site address ([www.collegesavingsmd.org](http://www.collegesavingsmd.org)).

As a result of significant price increases in the Prepaid College Trust over the past two years, the Trust has focused on promoting the value to families of purchasing less than four years of college at the time of initial enrollment. Families who enroll for less than the four-year university plan can purchase additional years later, even though they will pay what those years cost at the time of enrollment; however, the family has an opportunity to lock in current prices for some number of years of college during this enrollment period. Also, families are being encouraged to consider the Trust's lowest priced plan, the 2-year community college plan, which does not restrict beneficiaries to attending a community college and allows families a more affordable option to purchase tuition benefits towards two year of college.

The Board wants to continue to promote interest in both the Prepaid College Trust and the College Investment Plan and has submitted changes through two legislative proposals. HB 894 would provide an exemption from State procurement law that would enable the Board to investment funds from the Prepaid College Trust in separately managed accounts, instead of only in mutual funds as has been done since the Trust opened in 1998. This change is projected to save the Trust over \$2.3 million in reduced investment fees over the next 5 years. Also, HB 447 would provide the Board with an additional month to submit its Annual Report to the Governor and the General Assembly, due to the increased complexity of issuing a single annual report for two plans.

### **Agency Budget**

#### **Revenue Sources**

The Board's revenue sources are comprised of the following:

- ✓ Enrollment fees in the Prepaid College Trust
  - \$75 per initial account, which is intended to cover costs associated with acquiring new accounts in the Trust.

- ✓ One half of the enrollment fees in the College Investment Plan
  - \$45 per initial account between an account holder and beneficiary intended to recover the Board's costs of overseeing the College Investment Plan.
- ✓ Percentage of Trust contract payments, currently 2.25%, which is intended to recover ongoing costs of maintaining Trust accounts.

## **FY 2004 Enrollment Fee Revenues**

While enrollment in the College Investment Plan exceeded initial projections, the Board's total enrollment fee revenue is also highly dependent on meeting enrollment projections in the Prepaid College Trust. As previously stated, total enrollment in the Trust will not be known until April at the conclusion of the Prepaid College Trust's enrollment period.

## **FY 2004 Expenses**

The agency's expenses can be generally categorized in three main areas: (1) salaries, benefits and employee-related expenses for the nine (9) permanent agency employees; (2) administrative expenses to maintain accounts and providing customer servicing for current participants; and (3) marketing costs to acquire additional participants.

These expenses are predominantly fixed and cannot be further reduced without incurring a significant change in the Trust's operations and ability to provide quality service to current participants and acquire new participants in an effective manner.

Currently, there is an overall budgeted increase in expenditures from FY04 to FY05 of about \$110,000. While there are minor increases and decreases in various areas, the increase in total expenses is primarily personnel related and includes a step increase for non-executive positions and benefits expense calculated based on state mandated rates. There are no changes in headcount.

## **Loan Repayment**

The Board has included a loan payment in its FY04 budget of \$120,000 and has budgeted the same for FY05.